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New budget policy: weaker tenge - fuller the budget

Abstract

Higher oil prices with low tenge even with elevated State budget expenditures brought consolidated budget closer to balance in 2018, reserve accumulation of National Fund resumed, along with this increased budget dependence on oil, use of extra-budgetary funds (NBRK, ENPF) also rose.

State budget revenues rose by 15% in 2018, the strongest increase in taxes was observed from the external sector that advanced faster than growth in GDP, with weaker domestic taxes, thus reflects a weak recovery of non-commodity sector. State budget expenditures rose by 9%, the main growth occurred in the social sphere, where expenditures amounted to nearly 5% of GDP, among other large articles there has been negative dynamics. State budget deficit (excluding National Fund) amounted to T833 bn or 1.4% of GDP in 2018, which is the best number for the past more than 10 years.

The main effect on the growth of the State budget revenues in 2018 had oil prices that jumped by 30%, growth in volume of exports of mineral fuels by 4%, as well as the weakening of the tenge by nearly 17% from the second quarter last year. As a result the dependence of budget revenues on the oil sector increased further, the share of oil revenues in the consolidated budget had risen to 36% in 2018 from 29% in 2017.

More than two-fold depreciation of tenge is a compensatory mechanism for falling oil prices, thanks to which the consolidated budget income is almost recovered to pre-crisis levels, when crude oil stood at higher than $100 per barrel. At the same time this means that the burden of filling the losses in revenue ultimately passed on to the private sector and the population, as evidenced by the growth of the economy, contrasted with jump in bad loans and shrinkage of real wages.

Income taxes of National Fund reached T3.2 tn in 2018 and was lower of 2015 record just by T267 billion, while revenues exceeded withdrawals for the first time since 2015, thus resumed accumulation of oil revenues in 2018, while the funds of the National fund exceed 40% of GDP. Foreign currency assets also showed a slight increase to $57.7 bn.

Another pack of support for the banking system contributed to the high non-oil deficit of approximately -8% of GDP in 2018 (-12.8% of GDP in 2017) and demonstrates the continuing risks in the banking system as a result of underdevelopment of non-primary parts of the economy.

After reducing the use of funds of the National Fund the State reverted to the resources of quasi-public sector, the National Bank and ENPF whose share in consolidated budget expenditures amounted to 5% in 2018 and probably will reach 8% this year on the back of continuing support of banks. Reallocation of budget monies towards quasi-public sector, including extra-budgetary funds, supports a high share of the State in the economy and is not conducive for the development of non-commodity sector.

State budget

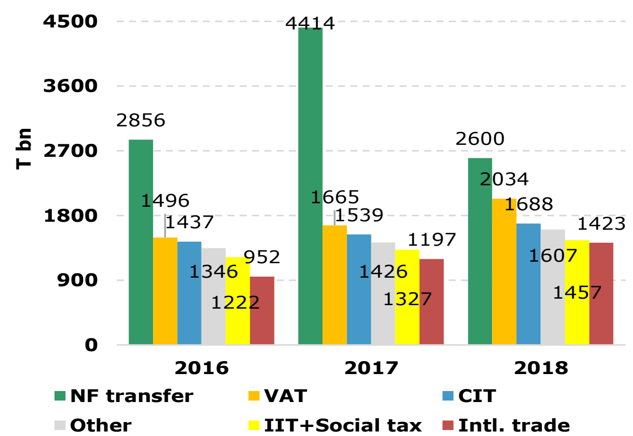
State budget revenues [1]

State budget revenues (excluding National fund transfers) grew by T1 tn or 15% yoy to T8.2 tn in 2018, as a result of increased tax revenue by almost 16% and overfulfillment of plan by 2%. National Fund transfers excluding T2.1 tn on improvement of the banks in 2017 increased by T0.3 tn or 13% yoy to T2.6 tn (fig. 1). National Fund transfers remain the most significant revenue source of the budget reaching 24% of the total and by 30% higher than revenue from VAT, the largest article among tax revenues. Breakdown by tax revenues show increase in CIT +10% yoy, individual income tax (IIT) +12% yoy, social tax +7% yoy, VAT +22% yoy. receipts of VAT on goods and services produced in Kazakhstan increased by 48% yoy due to the low base in the same period last year and growth of oil processing, taxes from imports have grown by 10%.

Increase of revenues from IIT and social tax has been accompanied by an increase of nominal wages by 7% and reduced size of social tax from 9.5% to 7.5% in 2018, with a small overfulfillment of plan. Revenue growth of 22% from VAT moved well ahead of imports at 11% yoy in January-November of 2018, and increase in the nominal trade turnover by 15% yoy. The significance of VAT to the budget is maintained at a high level, the share of revenues from VAT relative to GDP increased to 3.4% (fig. 2) in 2018 (3.1% in 2017).

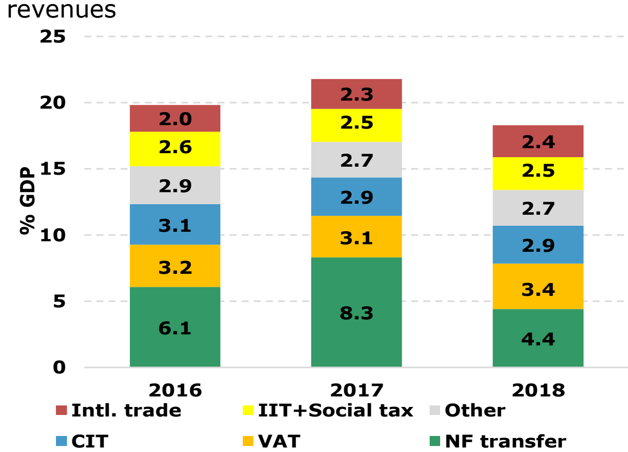
Corporate income tax receipts have not changed, the share of tax revenue relative to GDP remained at 2.9% but below 3.1% in 2016. It should be noted that income from CIT were by 4% below the plan that can be associated with problems in non-primary parts of the economy, for example, in the two regions and Astana GDP contracted (9M2018), weak economic growth was in four regions and Almaty, where the growth was below 3% as compared to 4.1% on average.

Figure 1 State budget revenues



Source: MoF RK

Figure 2. Relative indicators of State budget revenues



Source: MoF RK

State budget expenditures

State budget expenditures rose by 9% in 2018 to T11.3 tn (excluding T2.1 tn for non-performing loans Fund in 2017) versus the same period of last year. Pursuant to the plan expenditures amounted to 99.7%.

Spending on education, health and culture grew by 6% in 2018. In turn, social welfare costs have increased by almost 20% yoy as a result, the share of these expenses to GDP had risen to 4.7% from 4.2% and 4.3% in 2016 and 2017. (fig.3,4). Growth in social expenditures helped to mitigate the negative impact of the depreciation of tenge and inflation in 2015-2017, when real wages fell by 5% while pensions in real terms increased by 7%. The total costs on social block was 56% and remained at a high level. Financing of public services such as defense, public order and other increased by 7% yoy.

The outlays on the economy rose by 3% yoy, include items such as: agriculture, infrastructure, industry, housing and communal services, etc. The largest costs weight falls on infrastructure because of the implementation of State program "Nurly Zhol", which costs roughly correspond to half a trillion tenge per year.

[1] Republican and local budgets

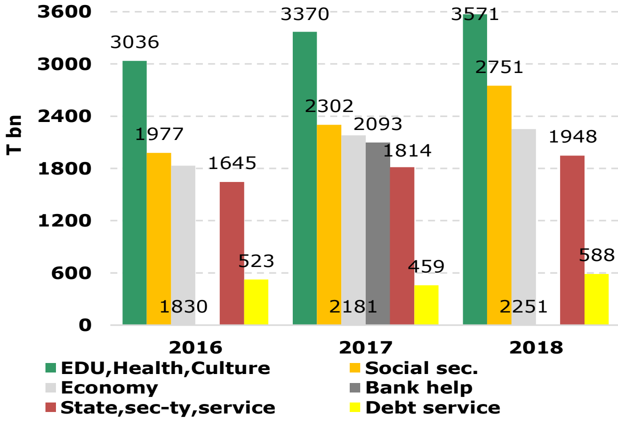
Under debt service costs increased by about 28% yoy. Impact was provided by weaker tenge since April this year, given that more than a third of State debt accounts for external loans. It should be noted that the Ministry of finance in early November placed 5-10-year bonds at the sum of EUR1 bn.

Under budget category Budget credits costs amounted to T250 bn. The main article is loans to Agrarian Credit Corporation to support agricultural producers T60 bn and lending to Baiterek worth T86.5 bn for various State programs. Funds were also allocated for the development of entrepreneurship, employment, etc.

By budget category financial assets acquisition costs decreased significantly to T52 bn (T196 bn in 2017. The capital of State-owned companies in the space, infrastructure and agro-industrial sectors was increased.

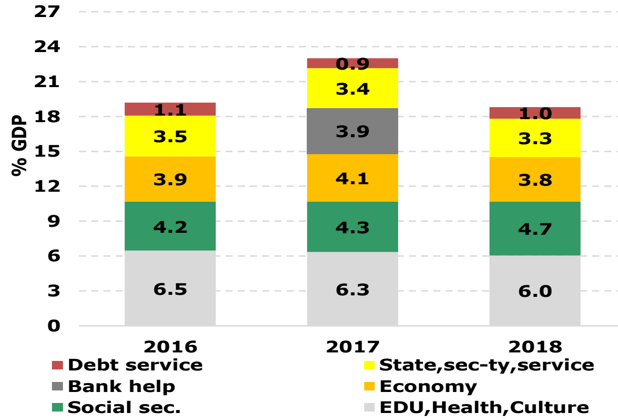
Meanwhile State budget deficit (excluding the National Fund) amounted to T833 bn or 1.4% of GDP and significantly decreased from 2.7% of GDP in 2017, and 2.1% of GDP on average in 2014-2017. The size of public debt has increased to 26% of the country's GDP from 25.4% in the previous year.

Figure 3. State budget expenditures



Source: MoF RK

Figure 4. State budget expenditures, share



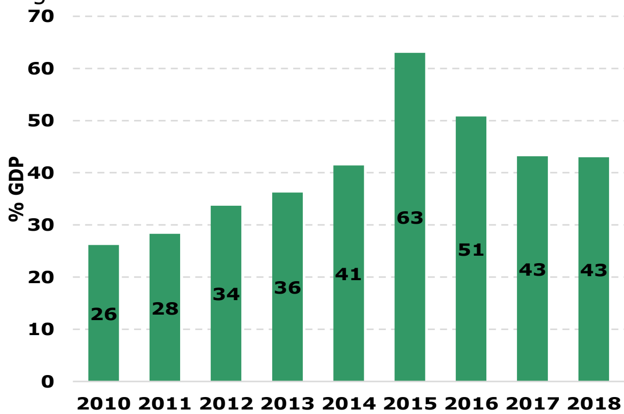
Source: MoF RK

National Fund

Income taxes of the National fund grew by 60% yoy to T3.2 tn and was driven by the increase in the cost of oil by 30% and increasing exports of mineral fuels by 4%. Growth ensured income from CIT by 76% yoy, income from the share of the republic in the product sharing agreements more than doubled, income from the rent tax on exports and bonuses up two times, MET tax showed 26% decline yoy. Taking into account the fall of income from MET tax, the income from the share of the republic in the product sharing agreements moved to second place by size T725 bn (T286 bn in 2017) that can be attributed to the impact of Kashagan and TCO, where production is steadily increasing.

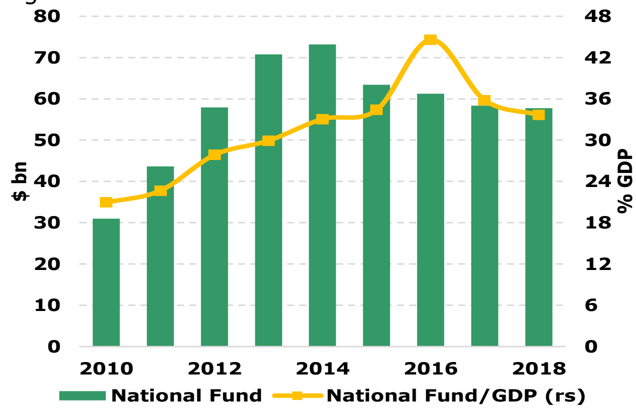
Use of funds of the National Fund amounted to T2.6 tn until October in 2018, after which revenues began to accumulate that happened for the first time since 2015 due to revenue growth from exports and weaker tenge, as well as the termination of funding for the target transfer. As a result the National Fund accumulations have stabilized at 2017 level of 43% of GDP (Fig.5). Foreign currency assets of the National Fund, which have been declining since the beginning of the year, grew slightly since October and stood at $57.7 bn at the end of the year (fig.6) ($77 bn at its peak in 2014).

Figure 5. National fund accumulations



Source: MoF RK

Figure 6. National fund FX assets

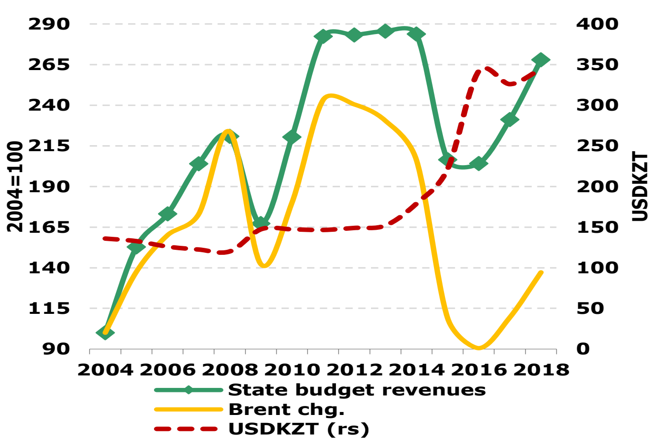


Source: MoF RK

Consolidated budget

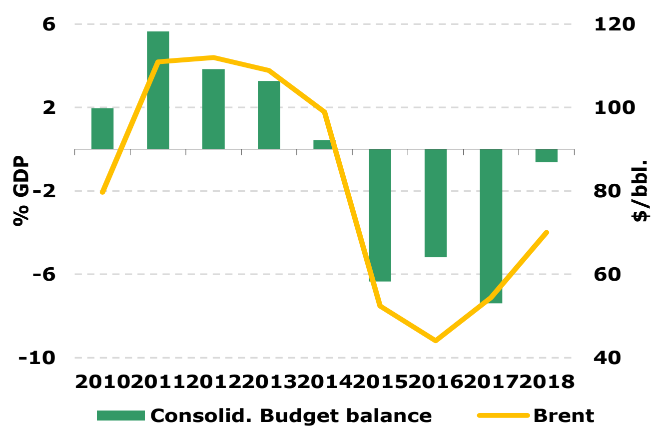
Oil price in the budget was increased from $55 to $65 per barrel in 2018, in the view of weaker exchange rate revenues of the budget has increased considerably. It should be noted that for the period of low oil prices in the 2015-2018, when the average price of oil was $55 per barrel, the weak exchange rate of tenge at around 340 on average in the same period played a crucial role in the maintenance of State budget revenues. The extreme dependence of budget revenues on the oil sector shows almost 100% correlation between real changes in oil prices and real incomes of the State budget (Fig.7,8), where due to weak tenge in recent years budget incomes came closer to the level of 2010-2014 when the average price of oil corresponded to $100 per barrel. It is important to note that in addition to the positive effect of increased expenditures to support the economy in times of crisis, significant funds were spent to aid banks, which was rather fire measure because it was aimed at combating the effect, not the cause – the root of the problems lies in the structural problems in the economy accumulated under the influence of the manifestations of "Dutch disease" and the lack of progress in correcting the historical bias towards commodity sector. For example, without bloated spending to rescue the banks and other inefficient expenditures the deficit of the consolidated budget wouldn't have exceeded 3% of GDP on average in 2018, in turn, tenge could have been stronger, whereas in the current environment because of depreciation of the national currency population and the private sector pay via the loss in their incomes.

Figure 7. Weak tenge corrected budget incomes



Source: MoF RK, NBRK, Bloomberg

Figure 8. Oil dependence of the budget



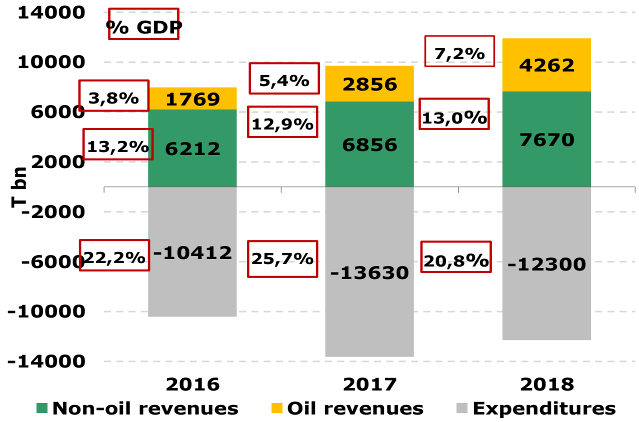
Source: MoF RK, Bloomberg

Consolidated budget expenditures declined by 10% relative to the corresponding period of 2017 to T12.3 tn because of smaller amount of funds allocated for the salvation of banks, at about T0.6 tn (T2.1 tn in 2017). Expenditures relative to GDP fell to 20.8%, the lowest level since 2014, due to support of banks their size amounted to 25.7% of GDP in 2017, 22.2% in 2016 and 23.6% of GDP in 2015. Tsesna Bank support in 2018 was at T450 bn through the sale of loans portfolio to JSC "The problem loans fund».

Within the framework of the program to enhance liquidity in the amount of T67 bn ENPF acquired bank bonds, T83 billion were invested by him in the construction of the gas pipeline "Saryarka". This support by the State was taken into account when assessing consolidated budget. General government deficit decreased to T0.4 tn in 2018 against deficit of T3.9 tn in 2017 and is the lowest since 2014 (fig.10).

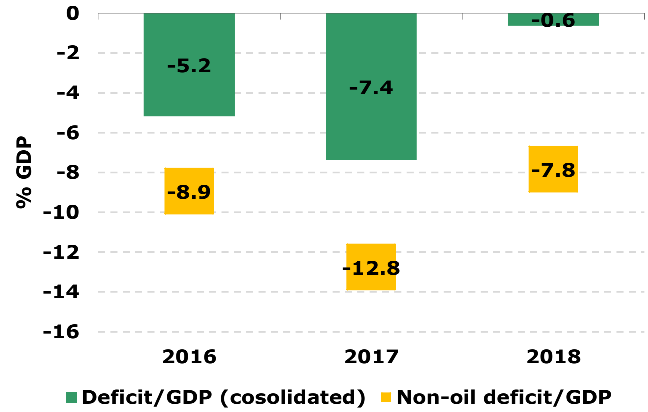
It should be noted that investment income of T1.8 tn was taken into account in the official consolidated budget income, and thus official consolidated balance of the budget was positive, but this revenue reflects the exchange currency changes and in accordance with the IMF's ruling on State finances should have been taken into account in estimation of the assets of the National Fund, rather than artificially inflating non-oil revenues to balance the budget and lower non-oil deficit.

Figure 9. Consolidated budget revenues and expenditures, tenge, % GDP



Source: MoF RK

Figure 10. Consolidated and non-oil deficit



Source: MoF RK

Non-oil consolidated budget deficit, according to our assessment, totaled T4.6 tn in 2018 and decreased from T6.8 tn in 2017, in relative terms, non-oil deficit declined to -7.8% of GDP (fig.11) from 12.8% of GDP in 2017.

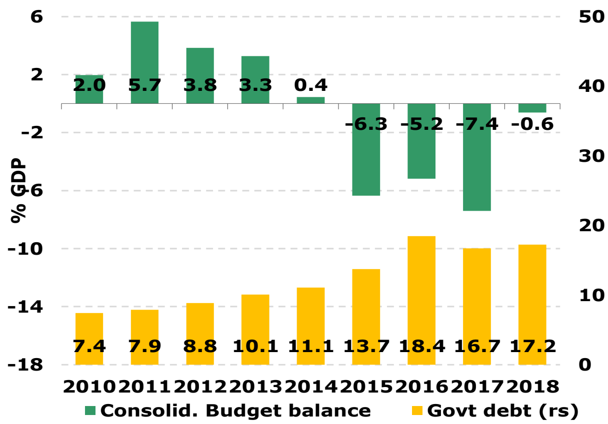
With the reduction in the use of funds of the National Fund at the expense of discontinuing use of target transfer from 2018, the State began actively involve extra-budgetary funds for the banking system needs. In 2018 State financial authorities deployed approximately T0.6 trillion, this year the program of increase of liquidity provides funds at T533 bn from joint funds of the National Bank and of ENPF. JSC "The problem loans fund acquired from JSC Tsesnabank» portfolio of agricultural loans worth T604 bn. As a result, given these costs non-oil consolidated budget deficit increased by these amounts. In accordance with the rules on government finance statistics, these funds must be consolidated in the expenditures of the budget, resulting in the non-oil deficit of the consolidated budget possibly reaching -8% of GDP.

Thus, despite declaration of target to reduce budget dependence on the oil sector, this process is slow, to which apparently contributed oil prices, which rose by 30% to an average of $70 per barrel in 2018. According to the concept on the formation and use of funds of the National Fund, the non-oil deficit of the Republican budget as a percentage of GDP in 2017 has been set at 9.3%, actual figure increased to 12.8% to GDP. In the 2018 the size of non-oil deficit, by our estimates, was 7.8% of GDP when ceiling under the concept was at -7.4% of GDP. This year non-oil deficit cap was set at -7.2% of GDP, but due to repeated breaches by the State of self-imposed restrictions there is no certainty that non-oil deficit will not exceed the cap again. Such significant deviations from the previously approved policy of reducing budget dependence on the oil sector demonstrate low execution discipline of non-oil deficit reduction plans, established by the concept on the formation and use of funds of the National Fund. It should be noted that the financial authorities are in no hurry to make country's financial report fully in accordance with international standards on statistics of public finances, resulting in no inclusion of financial transactions with the National Bank, ENPF, quasi-government sector, while the share of their participation in the consolidated budget expenditures reached around 5% on average from 2010.

Moreover, in accordance with internationally recognized "government finance statistics guide", budget credits and operations with financial assets within the budget in practice of Kazakhstan include funding for State-owned companies, carried out from the national fund or the National Bank, which leads to the redistribution of State funds in favor of a quasi-public sector, these operations are often not transparent.

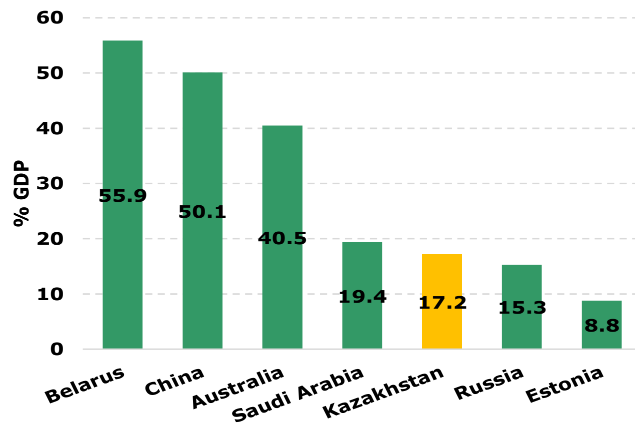
On the backdrop of anti-crisis support of the economy, the size of Government debt almost doubled in Kazakhstan since 2011 reaching 17.2% of GDP (Fig.11,12) that clearly characterizes the high dependence of Kazakhstan on oil sector, as a result, our country has found itself among the list of oil-producing countries with the highest increase in government debt during that period, so according to IMF in Azerbaijan and Algeria, it grew 2.5 times, 4 times in Kuwait, 5 times in Saudi Arabia. Moderate increase in government debt over the past 6 years has demonstrated Norway by 20%, Mexico by 26%, Russia by 30%. However, due to the presence of National fund reserves, the size of government debt is at a low level in comparison with countries with emerging markets, where its size is 50% of GDP on average.

Figure 11. State budget balance and Govt. debt



Source: MoF RK

Figure 12. Govt. debt by country



Source: MoF RK, IMF

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